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5/3/83

Financial Markets

Irving Trust

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Friday (Noon) Apr. 29, 1983

Once again the money markets are going through a period where technical factors dominate market rate movements. In the last calendar week, the Federal Reserve has done two repurchase transactions for the Federal Reserve's own account (System RPs). Some market participants have looked to this as a sign that the Fed is changing its policies and trying to move interest rates lower. But such is not the case this time. The System RPs may in fact be "aggressive" (large in size), but they are primarily "defensive"--they are intended to offset a drain of bank reserves rather than to inject new reserves.

April normally is a time when the Federal Reserve has to act somewhat aggressively to keep reserves from being drained from the banking system. During April the U.S. Treasury is receiving tax payments from the public, and these are the source of the problem. As the Treasury processes checks reflecting tax payments to it and as these "clear," the funds are transferred to the Treasury's account held at the Federal Reserve. The Treasury targets in-payments and out-payments through this account to maintain an average balance of about $3 billion. Payments to the Treasury that would push the balance of its account at the Fed above its target level are transferred to banks and must be collateralized with government securities to protect the value of the Treasury's deposits. This transfer keeps the reserves in the banking system. Were the Treasury just to run up its balance at the Fed, a drain in bank reserves would occur. If the drain were not offset by some other injection of reserves, upward pressure on the Fed funds rate would result.

The stipulation that Treasury deposits be collateralized causes banks to set limits on the volume of these deposits that they will accept. As a result, in April, these Treasury accounts become filled to capacity and lead to an increase in Treasury deposits at the Fed, thus draining reserves. To offset this drain, the Fed has very few options. First, if the Fed had done a large volume of internal matched sales with its customers (primarily foreign central banks) the previous week, it could let these run off, thereby resupplying reserves to the banking system; and it would refuse to do any more matched sales with customer accounts. This would mean passing through to the market all customer orders (customer RPs). However, it is unlikely that the Fed would be able to match precisely its open market reserve needs with the investment desires of its customers. Second, the Fed could do an outright purchase of securities with the market and inject reserves, but this activity is usually reserved for "permanent" reserve injection. Third, the Fed could sell dollars and buy foreign exchange as many foreign countries do; but this action is almost never undertaken for reserve management purposes in the U.S. Thus the Fed is left to do System RPs. One danger of this is that the market often views actions for the System's own account as more aggressive and therefore as a clue as to where interest rates are going. At this time, however, the System RPs are accompanied by a high level for Fed funds, near 9%. The rising rate for Fed funds clearly indicates that the Fed is not pushing interest rates down. The System RPs are purely technical.

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Market Yields

	4/29/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.75	8.50	15.25
Repurchase Agreements	8.50	8.50	12.63
U.S. Treasury Issues			
Bills			
3 months	8.30	8.44	12.82
6 months	8.56	8.74	13.45
1 year	8.71	8.98	13.57
Coupons			
2 years	9.36	9.60	13.93
4 years	9.74	9.97	13.90
7 years	10.14	10.35	13.83
10 years	10.27	10.44	13.83
Long Bond	10.38	10.54	13.35
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.50	14.15
3 months	8.35	8.55	14.15
6 months	8.45	8.75	14.15
1 year	8.90	9.15	14.15
Banker's Acceptances			
1 month	8.46	8.50	14.10
3 months	8.43	8.55	14.10
6 months	8.55	8.75	14.20
Eurodollar Deposits			
1 month	8.81	9.06	15.06
2 months	8.88	9.13	15.00
3 months	8.88	9.19	14.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.63	13.98
1 month	8.56	8.68	14.50
3 months	8.54	8.81	14.31
Bank Holding Companies			
1 month	8.17	8.30	14.10
Dealer Placed:			
3 months	8.56	8.54	14.66
New AA Corporate Utility Bond	11.60	11.65	16.13
Tax Exempt			
6 month Project Notes	4.80	5.20	7.50
1 year AAA Bond	4.75	5.25	7.25
5 year AAA Bond	6.30	6.40	8.75
20 year AAA Bond	8.20	8.60	10.80

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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